

Tulsa Law Review

Volume 33
Issue 3 *Mineral Law Symposium*

Spring 1998

Roye Realty & Developing, Inc. v. Watson: Oklahoma Decides the Royalty Obligation on Take-or-Pay Settlements Using Plain Terms Analysis

Gene G. Boerner III

Follow this and additional works at: <https://digitalcommons.law.utulsa.edu/tlr>



Part of the [Law Commons](#)

Recommended Citation

Gene G. Boerner III, *Roye Realty & Developing, Inc. v. Watson: Oklahoma Decides the Royalty Obligation on Take-or-Pay Settlements Using Plain Terms Analysis*, 33 Tulsa L. J. 891 (2013).

Available at: <https://digitalcommons.law.utulsa.edu/tlr/vol33/iss3/5>

This Legal Scholarship Symposia Articles is brought to you for free and open access by TU Law Digital Commons. It has been accepted for inclusion in Tulsa Law Review by an authorized editor of TU Law Digital Commons. For more information, please contact megan-donald@utulsa.edu.

ROYE REALTY & DEVELOPING, INC. v. WATSON: OKLAHOMA DECIDES THE ROYALTY OBLIGATION ON TAKE-OR-PAY SETTLEMENTS USING “PLAIN TERMS” ANALYSIS

Gene G. Boerner III[†]

I. INTRODUCTION

There are few cases in the field of oil and gas law that have generated as much attention and anticipation as *Roye Realty & Developing, Inc. v. Watson*.¹ Take-or-pay settlements amounted to billions of dollars nationwide,² and there is currently a meager amount of case law on the resulting royalty obligation. Oklahoma's decision would affect considerable interests in the oil and gas industry. The question of whether royalty is due on take-or-pay settlements was to be answered by Oklahoma's highest court. The answer was both surprising and unsettling. Using strict notions of contract interpretation, the court ruled that royalty is not due on take-or-pay settlements. At the heart of the court's lease interpretation was its statement that “production” meant actual and physical extraction of the mineral. In defining “production,” the court departed from its own precedent and confused the state of fundamental principles of Oklahoma oil and gas law.

This paper will discuss the two leading theories of lease interpretation relied upon by courts in deciding whether royalty is due on take-or-pay payments and settlements. Against this theoretical backdrop, the decision in *Roye Realty* will be analyzed to determine the nature of the reasoning adopted by the Oklahoma Supreme Court in resolving the issue of whether royalty is due on take-or-pay settlements. Furthermore, the *Roye Realty* court's failure to apply traditional notions of Oklahoma's oil and gas law will be discussed, and the

[†] Associate, Pezold, Richey, Caruso & Barker, Tulsa, Oklahoma. J.D., 1997, University of Oklahoma; B.A., 1994, University of Tulsa. The author gratefully acknowledges the support and commentary of friends, colleagues, and professors with regard to the development of this paper.

1. 949 P.2d 1208 (Okla. 1996).

2. See John S. Lowe, *Defining the Royalty Obligation*, 49 SMU L. REV. 223, 227 (1996) (estimated take-or-pay settlement costs are in the range of twelve to fifteen billion dollars).

difference in the outcome of *Roye Realty* from decisions in similar jurisdictions will be examined. To the extent possible, this paper will attempt to harmonize the *Roye Realty* decision with Oklahoma precedent and the theories relied upon by similar jurisdictions in deciding the same issue.

This paper will also set forth an argument that royalty owners can prevail under the plain-terms analysis adopted in the *Roye Realty* decision, given favorable definitions of the key lease terms. Additionally, this paper will discuss the implications of the plain-terms analysis on other portions of producer-purchaser settlements that do not represent take-or-pay settlements.

II. THEORIES APPLIED IN DECIDING WHETHER ROYALTY IS DUE ON TAKE-OR-PAY SETTLEMENTS

There are essentially two lines of reasoning that have developed in determining whether royalty is due on take-or-pay benefits. Courts finding in favor of the producer/lessee generally apply strict interpretations of contract terms, and as a result have been referred to as "plain-terms" jurisdictions.³ Plain-terms jurisdictions find the standard royalty clause to be unambiguous and determine the royalty obligation based on the legal meaning of the terms in the lease. Since most leases limit the royalty obligation to gas "produced," plain-terms courts find that no royalty is owed on take-or-pay payments that are made in lieu of production.

Although plain-terms decisions have favored producers, a royalty owner may prevail in plain-terms jurisdictions that have a broad definition of "production." For instance, in jurisdictions where "production" under the lease is defined as "capability of production," take-or-pay payments may be construed as royalty-bearing under the plain terms of the lease. The rationale is that take-or-pay payments are made for gas that the producer is capable of producing, but that the purchaser does not take. Therefore, the "capability of production" is marketed under the gas purchase contract via the take-or-pay clause, and royalty is owed under the plain terms of the lease. However, no plain-terms jurisdiction has adopted this argument.

Other jurisdictions might be described as "cooperative venture" jurisdictions, because their decisions are based on notions of the lessor-lessee relationship represented in an oil and gas lease.⁴ Cooperative venture jurisdictions have found the royalty clause to be ambiguous with regard to take-or-pay payments and look to the purpose behind the lease to resolve the issue. These courts have generally ruled in favor of royalty owners. Currently, the majority of courts faced with the issue of royalty on a take-or-pay basis have adopted the plain-terms analysis.⁵ However, there is reason to believe that the cooperative ven-

3. See *id.* at 235.

4. See *id.*

5. See *Diamond Shamrock Exploration Co. v. Hodel*, 853 F.2d 1159 (5th Cir. 1988); *Harvey E. Yates Co. v. Powell*, 98 F.3d 1222, 1230 (10th Cir. 1996) (recognizing the plain-terms analysis as the majority

ture theory will become more widely accepted as better recognizing the reality of what is an inherently complex issue.⁶

A. "Plain-terms" Jurisdictions: Arguments Favoring Producers

*Diamond Shamrock Exploration Co. v. Hodel*⁷ is probably the most widely cited plain-terms case.⁸ In *Diamond Shamrock*, the Fifth Circuit Court of Appeals was faced with the issue of whether royalty was due on take-or-pay payments under the provisions of a federal offshore lease.⁹ The lease clause called for royalty of "16 2/3 percent in amount or value of production saved, removed, or sold from the leased area."¹⁰ The court determined that the plain meaning of the terms in the royalty clause was dispositive.¹¹ Under the court's interpretation, "production" does not occur until there is actual severance of the minerals from the formation.¹² There must be production in order for there to be something to value for purposes of the royalty clause.¹³ Therefore, royalty payments are not due on take-or-pay payments unless and until gas is actually severed and taken.¹⁴ Furthermore, the court determined the nature of take-or-pay payments as being "intended to compensate primarily the producer, not the owner of the minerals, for the risks associated with development production."¹⁵

Diamond Shamrock represents the prototypical plain-terms argument. The court's definition of "production" leads to the quick resolution that take-or-pay payments are not subject to royalty. Plain-terms jurisdictions define "production" as actual severance of the minerals. Since take-or-pay payments are for gas not produced or taken, the royalty clause is not triggered. Moreover, plain-terms jurisdictions generally agree with the idea that take-or-pay payments serve primarily to compensate the producer for risks and ensure a predictable stream of income. Therefore, a lessor should not be allowed to share in such payments. Other plain-terms cases have expanded the typical argument to address the competing cooperative venture theory.

view); *Killam Oil Co. v. Bruni*, 806 S.W.2d 264 (Tex. Ct. App. 1991); *State v. Pennzoil Co.*, 752 P.2d 975 (Wyo. 1988).

6. See Lowe, *supra* note 2, at 252-53 (citing three factors in support of this conclusion: the theory that the lease is a cooperative venture makes sense in lease transactions, examining the plain terms makes little sense in the context in which leases are made and used, and the history of royalty disputes supports the cooperative venture theory).

7. 853 F.2d 1159 (5th Cir. 1988).

8. See Lowe, *supra* note 2, at 237.

9. See *Diamond Shamrock*, 853 F.2d at 1161, 1163.

10. *Id.* at 1163.

11. See *id.* at 1165.

12. See *id.* at 1168.

13. See *id.* at 1167.

14. See *id.* at 1168.

15. *Id.* at 1167. But see Randy King, *Royalty Owner Claims to Take-or-Pay Payments under the Implied Covenant to Market and the Duty of Good Faith and Fair Dealing*, 33 S. TEX. L. REV. 801, 821 (1992) ("[W]hy should the purpose for which the lessee and the pipeline enter into a gas contract dictate the terms of the relationship between the lessor and the lessee? Generally, the oil and gas lease establishes the lessor-lessee relationship before the gas contract comes into existence. The subsequent creation of the gas contract between the lessee and the pipeline should not then change the lessor-lessee relationship.").

In *Harvey E. Yates Co. v. Powell*,¹⁶ the Tenth Circuit Court of Appeals addressed claims by a state lessor for royalty on take-or-pay payments made in settlement of gas purchasers' obligations.¹⁷ The relevant royalty clause provided that "lessee shall pay lessor as royalty one-eighth of the cash value of the gas, including casing-head gas, produced and saved from the leased premises and marketed or utilized."¹⁸ The court recognized that a "lease must be given the legal effect resulting from a construction of the language contained within the four corners of the instrument" unless its provisions are ambiguous.¹⁹ Ambiguity exists only where the contract language may be "fairly and reasonably construed in different ways."²⁰

The court found the royalty clause to be clear and unambiguous under its plain terms.²¹ The lessee was not obligated to pay a royalty on the cash value of gas except to the extent that such gas was produced and saved from the leased property.²² Production under the royalty clause required physical extraction of the gas from the land.²³ Royalty is not due on take-or-pay payments except on amounts recouped by the purchaser in the form of actual production, and not until such point of recoupment does the royalty obligation arise.²⁴ The court distinguished jurisdictions adopting the cooperative venture approach in that such jurisdictions had unique state statutes in place which gave an expanded meaning to the term "royalty."²⁵ The court predicted that New Mexico would not adopt a cooperative venture analysis because no similar royalty-defining statute existed in New Mexico.²⁶

The court in *Harvey E. Yates* makes an interesting point in that the cooperative venture jurisdictions both have statutes in place defining "royalty" in a rather broad way. It is unclear, however, how much impact these statutes had in influencing the choice of a cooperative venture analysis.²⁷ To the extent a

16. 98 F.3d 1222 (10th Cir. 1996).

17. *See id.* at 1229.

18. *Id.* The language of this clause was taken from the New Mexico statutory lease found at N.M. STAT. ANN. § 19-10-4.1 (Michie 1994).

19. *Id.* at 1230 (quoting *Owens v. Superior Oil Co.*, 730 P.2d 458, 459 (N.M. 1986)).

20. *Id.* (quoting *Harper Oil Co. v. Yates Petroleum Corp.*, 733 P.2d 1313, 1316 (N.M. 1987)).

21. *See id.*

22. *See id.*

23. *See id.* *See also* *Diamond Shamrock Exploration Co. v. Hodel*, 853 F.2d 1159, 1165 ("[R]oyalties are not owed unless and until actual production."); *Killam Oil Co. v. Bruni*, 806 S.W.2d 264, 267 (Tex. App. 1991) ("[T]he lease entitled the [lessor] to royalty payments on gas actually produced."); *Mandell v. Hamman Oil & Ref. Co.*, 822 S.W.2d 153, 165 (Tex. Ct. App. 1991) ("Production is the key to royalty."); *State v. Pennzoil Co.*, 752 P.2d 975, 981 (Wyo. 1988) ("By its clear terms, [the lease] manifests the intention of the parties that royalty payments were to be made only in the event of production from the lease, that is, after physical extraction of the gas from the land and its sale or use.").

24. *See Harvey E. Yates*, 98 F.3d at 1236.

25. *See id.* at 1233. *See also* *Lowe*, *supra* note 2, at 257 ("[B]oth *Frey* and *Klein* were based in part upon unusual state statutes that may expand the royalty obligation on an unjust enrichment theory. . . . Most states, including Oklahoma, apparently have no such legislation. Thus, to the extent that *Frey* and *Klein* were based upon statutory language, they may stand alone." (emphasis added)).

26. *See Harvey E. Yates Co.*, 98 F.3d at 1234.

27. *See Frey v. Amoco Prod. Co.*, 603 So. 2d 166, 172 (La. 1992) ("[T]he rather expansive definition of royalty in [LA. REV. STAT. ANN. §31-213(5) (West 1992)] is not dispositive of the lessor's right to a royalty share of take-or-pay payments."); *Klein v. Jones*, 980 F.2d 521, 529 (8th Cir. 1992) (citing ARK. CODE ANN. § 15-74-705 (Michie 1987) as imposing duty on lessee to protect lessor's royalty interest); *See also* *Lowe*,

court desires a pro-producer outcome, the presence of these statutes makes a convenient distinction. However, there is no indication from the cooperative venture decisions that the presence of such statutes was anything more than just another factor in the courts' analyses.²⁸

In *Killam Oil Co. v. Bruni*,²⁹ trustee-lessors brought suit against lessees seeking royalty payments on take-or-pay settlement proceeds. The lease royalty clause provided for royalties to be paid on one-eighth of the amount realized "on gas, including casinghead gas and all gaseous substances, produced from said land and sold or used off the premises."³⁰ The lease alone is deemed to express the parties' intent unless a conflict or ambiguity exists.³¹ The court recognized that "it has become well established under Texas law that the term 'production' as used in oil and gas leases means actual physical extraction of the mineral from the soil."³² The court found that the parties knew how to provide for royalties, and the Trust "unambiguously limited its right to royalty payments only from gas actually extracted from the land."³³ Furthermore, "take-or-pay payments do not constitute any part of the price paid for produced gas, nor do they have the effect of increasing the price paid for gas that was taken."³⁴

The *Killam* court went further than most plain-terms opinions by implying that the parties—particularly the lessor—knew that take-or-pay payments would be received when the parties agreed to the language of the royalty provision.³⁵ To the extent either of the parties could have anticipated the chain of events leading to the massive take-or-pay obligations suffered by pipeline purchasers, such an argument is tenuous. This argument also fails to take into account that the drafting party and the more sophisticated party is usually the producer-lessee. The producer may well anticipate what kind of sales arrangements it will enter into, and whether the contract will have a take-or-pay provision. The lessor, who normally has no right under the lease to market gas and no capability to market gas even if he had the right, usually has no knowledge of the gas sales arrangements.

The plain-terms analysis has also been applied to cases where the royalty owner is claiming that royalty on take-or-pay payments is required under the implied covenant to market.³⁶ In *Mandell v. Hamman Oil & Refining Co.*,³⁷

supra note 2, at 257.

28. See *Lowe*, *supra* note 2, at 257.

29. 806 S.W.2d 264 (Tex. Ct. App. 1991).

30. *Id.* at 266.

31. See *id.* (citing *Sun Oil Co. v. Madeley*, 626 S.W.2d 726, 727-28 (Tex. 1981)).

32. *Id.* at 267. (citing *Gulf Oil Corp. v. Reid*, 337 S.W.2d 267 (Tex. 1960) and *Rogers v. Osborn*, 261 S.W.2d 311 (Tex. 1953)).

33. *Id.* at 268.

34. *Id.* But see *Frey v. Amoco Prod. Co.*, 603 So. 2d 166, 180 (La. 1992) ("[T]ake-or-pay payments effectively increase the price of gas actually delivered to the pipeline. Failure to characterize these payments as part of the total price paid for gas sold under the contract is to disregard the obvious economic considerations underlying the take-or-pay clause.").

35. See *Killam Oil Co.*, 806 S.W.2d at 268.

36. See *Mandell v. Hamman Oil & Ref. Co.*, 822 S.W.2d 153, 164-65 (Tex. Ct. App. 1991). See also Patrick H. Martin, *Implied Covenants in Oil and Gas Leases: Past, Present & Future*, 33 WASHBURN L.J.

the court held that a lessee's implied duty to market under an oil and gas lease is limited to marketing production, and therefore is not applicable to take-or-pay payments made in lieu of production.³⁸ While such a decision may pass muster in states defining "production" as actual extraction of the minerals, the same reasoning should support a royalty obligation on take-or-pay payments in states where "production" is satisfied by the capability of production. Furthermore, in a recent decision, a plain-terms jurisdiction has interpreted the implied covenant to market to require payment of royalties on settlement agreements that compromise the price of gas received under the gas purchase contract.³⁹

B. "Cooperative Venture" Jurisdictions: Arguments Favoring Royalty Owners

The cooperative venture analysis, which has its roots in principles suggested by Professor Thomas Harrell, is useful in weighing arguments presented in market value royalty cases.⁴⁰ Professor Harrell states:

[W]here the lessor's return from the contract is to be a fractional royalty based upon production, then, in a very loose and nontechnical sense, the arrangement is in the nature of a cooperative venture with the lessor contributing the land and the lessee contributing the capital and expertise necessary to develop the minerals for the mutual benefit of both parties. From this arises the affirmative, although implied, obligation of the lessee to market or dispose of the product in a reasonable and prudent way to secure the maximum benefit possible for both parties.⁴¹

Harrel identifies the purpose behind the royalty clause as fixing the division of economic benefits that the lessee and lessor hope to realize from the property.⁴² Furthermore, any determination of the market value of gas which permits the lessor or lessee to receive a greater amount of the gross revenues from the property than the fractional division provided for in the lease is inherently contrary to the basic nature of the lease.⁴³ These principles are useful in determining whether royalty should be paid on take-or-pay payments and are heavily relied on in the following cases.

In *Frey v. Amoco Production Co.*,⁴⁴ the Supreme Court of Louisiana answered a federally certified question of whether a lessor is entitled to royalties on take-or-pay payments made to a lessee by a natural gas pipeline purchas-

639, 653-58 (1994) (discussing implied covenant to market as it relates to current take-or-pay litigation).

37. 822 S.W.2d 153 (Tex. Ct. App. 1991).

38. See *id.* at 164-165. See also King, *supra* note 15, at 813.

39. See *Watts v. Atlantic Richfield Co.*, 115 F.3d 785, 794 (10th Cir. 1997) ("Under Oklahoma law, a producer . . . has the 'duty to market the gas produced from a well and to obtain the best price and terms available.' *Barby v. Cabot Corp.*, 550 F. Supp. 188, 190 (W.D. Okla. 1981) To prevail on their claim at trial, Lessors initially must show that a higher price was available at the time of the settlement agreement.").

40. See Thomas A. Harrell, *Developments in Nonregulatory Oil & Gas Law*, 30 INST. ON OIL & GAS L. & TAX'N 311, 334-37 (1979).

41. *Id.* at 334.

42. See *id.*

43. See *id.* at 336.

44. 603 So. 2d 166 (La. 1992).

er.⁴⁵ The lease's royalty clause provided a "royalty on gas sold by the Lessee [of] one-fifth (1/5) of the amount realized at the well from such sales."⁴⁶ The royalty clause did not refer to "production" or require that gas be "produced." While recognizing that the lease contract is the law between the parties, the court remained cognizant that the terms of such leases are not able to, nor were they intended to, accommodate every eventuality.⁴⁷ Finding it unlikely that the parties contemplated that producers would receive take-or-pay payments in settlement of gas contract litigation, the court determined that the royalty clause was ambiguous with regard to this issue.⁴⁸ Looking to the general intent of the parties to develop the land for the mutual benefit of both parties, the court reasoned that the royalty clause should be given an expansive reading.⁴⁹

The court stated that "the royalty clause is construed not in the abstract but in reference to the economic and practical considerations underlying the royalty interest and with due regard to the relationship between the lessor and lessee."⁵⁰ Finding a lease to be an inherently bargained-for-exchange, the court recognized that "a lessor would not relinquish a valuable right arising from the leased premises without receiving something in return."⁵¹ Recognizing the principles espoused by Professor Harrell, the court concluded that "an oil and gas lease, and the royalty clause therein, is rendered meaningless where the lessee receives a higher percentage of the gross revenues generated by the leased property than contemplated by the lease."⁵²

Addressing the argument that take-or-pay payments primarily compensate the producer for risks, the court said, "[I]t is a myopic eye which perceives the lessor as sharing none of the risks associated with bringing the gas to the ground."⁵³ Risk of drainage to the lessor's property was prevented inasmuch as the take-or-pay clause assures a relatively constant production of gas.⁵⁴ Furthermore, "both the lessee and the lessor share the risk of an erroneous market forecast by the lessee, the lessor's royalty being dependent on the producer-pipeline contract."⁵⁵

The *Frey* court differentiated the events necessary to trigger royalties on oil or gas. "[R]oyalty on oil and miscellaneous minerals is triggered by production."⁵⁶ Royalty on gas is generally not triggered by production because of the

45. See *id.* at 170.

46. *Id.* at 169.

47. See *id.* at 172.

48. See *id.*

49. See *id.* at 173.

50. *Id.*

51. *Id.*

52. *Id.* at 174. (citing *Henry v. Ballard & Cordell Corp.*, 418 So. 2d 1334, 1339 (La. 1982)).

53. *Id.* at 178. (citing William H. White, *The Right to Recover Royalties on Natural Gas Take-or-Pay Settlements*, 41 OKLA. L. REV. 663, 669 (1988)).

54. See *id.*

55. *Id.* at 179. However, it should be noted that the royalty interest owner gets one-eighth (approximately) risk-free, while the working interest owner gets seven-eighths to compensate the working interest owner for taking all of the economic risk. Therefore, it may be argued that the parties have already dealt with the allocation of risks in the royalty clause.

56. *Id.*

inability for lessor to store or transport the production.⁵⁷ However, the court stated that the parties could have conditioned payment of royalties on production of gas.⁵⁸ The implication is that a "production" gas royalty clause would have been dispositive of the matter in the lessee's favor.⁵⁹

The court concluded its analysis with a discussion of the economics behind take-or-pay clauses. "Because the producer is willing to negotiate a lower price in exchange for the guarantee the pipeline will either take or pay for a specific minimum quantity of natural gas, the take-or-pay provision effectively lowers the price the producer charges the pipeline per unit of gas."⁶⁰ It follows that the price of gas and the royalty owed would be higher absent the take-or-pay provision.⁶¹ The court applied this theory to conclude that the price of gas taken under the purchase contract included "not only the contract price paid per unit of gas delivered, but also the sums paid in the form of take-or-pay payments."⁶² "Failure to characterize these payments as part of the total price paid for gas sold under the contract is to disregard the obvious economic considerations underlying the take-or-pay clause."⁶³ There is a strong policy to allow lessors to share in take-or-pay payments to reduce the incentive of lessees to "compromise volume gas prices under their contracts or settlements in exchange for favorable take-or-pay terms."⁶⁴

Although the *Frey* economic analysis does not seem to be based upon expert testimony or studies, the *Frey* opinion is the most comprehensively reasoned of the decisions concerning royalty on take-or-pay payments. The *Frey* court's analysis of the purpose, economics, and risks inherent in both the royalty clause and the take-or-pay provision provides a springboard for future decisions addressing royalty issues. Indeed, the *Frey* reasoning was followed to a large extent in *Klein v. Jones*.⁶⁵

In *Klein*, the Eighth Circuit Court of Appeals decided the issue of whether royalty is due on take-or-pay settlements, applying Arkansas law.⁶⁶ The royalty clause at issue stated, "Lessee shall pay Lessor as royalty on gas . . . produced from said land and sold or used by Lessee . . . the market value at the mouth of the wells of one-eighth (1/8) of such products so sold or used."⁶⁷ The court rejected the lessors' argument that they were third-party beneficiaries of the gas purchase contract, instead finding that the lessors were merely incidental benefi-

57. *See id.*

58. *See id.*

59. Recall that the royalty clause in the *Frey* lease called for royalty on "amount realized." *See supra* text accompanying note 46.

60. *Frey*, 603 So. 2d at 180. (citing 4 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL & GAS LAW § 724.5 (1992)).

61. *See id.*

62. *Id.*

63. *Id.*

64. *Id.* at 182.

65. 980 F.2d 521 (8th Cir. 1992).

66. *See id.* at 531-32.

67. *Id.* at 525.

ciaries.⁶⁸ The court proceeded to decide the case based on the theory of unjust enrichment.⁶⁹

Reciting and agreeing with the reasoning in *Frey*, the court noted that “a restrictive interpretation of the royalties clause in a conventional lease can be inconsistent with its basic purpose and can produce results that are unintended by the parties, and unfair to the lessor.”⁷⁰ Recognizing the “Harrell rule,”⁷¹ the court found that take-or-pay payments should be distributed to royalty owners as a fair distribution of the mutual benefits that arise from the lease transaction.⁷² In doing so, the court expanded the cooperative venture analysis to apply to gas royalty clauses with production triggers. The unjust enrichment rationale allowed the court to consider extra-lease factors in interpreting the royalty clause, freeing the court to look past the term “production” in the royalty clause.⁷³

The effect the preceding analyses would have on Oklahoma courts was uncertain before *Roye Realty & Developing, Inc. v. Watson*.⁷⁴ In the absence of an objectively superior method, judges are vested with a great deal of influence in determining the outcome. As one scholar noted, “[i]f no uniquely correct resolution exists to a particular legal dispute, judges must decide as their personal convictions or political preferences dictate rather than as authoritative legal materials prescribe.”⁷⁵ Indeed, Professor John Lowe assessed that “jurists have ample ‘wiggle-room’” between the two approaches.⁷⁶ “The case and statutory law in Oklahoma, for example, is different enough from that of Louisiana and Arkansas to justify the Oklahoma Supreme Court’s refusal to order royalty on take-or-pay benefits.”⁷⁷ Lowe’s assessment proved correct.

III. THE ROYE REALTY DECISION

A. Facts and Procedural History

Roye Realty & Developing, Inc. (“Roye”), as lessee, and Watson, as lessor, entered into several oil and gas leases.⁷⁸ Roye drilled and completed gas wells capable of production in paying quantities on the leasehold property.⁷⁹ Roye then entered into a gas purchase contract with Arkansas Louisiana Gas

68. *Id.* at 527.

69. *Id.* (“[A] person shall not be allowed to profit or enrich himself inequitably at another’s expense . . .”).

70. *Klein*, 980 F.2d at 531.

71. *See supra* notes 40-43 and accompanying text.

72. *See Klein*, 980 F.2d at 531-32.

73. *See* Bruce M. Kramer, *Liability to Royalty Owners For Proceeds From Take-or-Pay and Settlement Payments*, 15 E. MIN. L. FOUND. §14.04 (1995).

74. 949 P.2d 1208 (Okla. 1996).

75. Eric Rakowski, *Posner’s Pragmatism*, 104 HARV. L. REV. 1681, 1682 (1991) (book review).

76. Lowe, *supra* note 2, at 267.

77. *Id.*

78. *See Roye Realty*, 949 P.2d at 1210.

79. *See id.*

Company ("Arkla") that contained a take-or-pay provision.⁸⁰ Roye and Arkla settled litigation over the take-or-pay clause in a confidential settlement agreement.⁸¹ Subsequently, a dispute arose between Roye and Watson over whether royalties were due on the settlement amount.⁸² Roye brought a declaratory action in state court asking the court to define the parties' rights and liabilities under the oil and gas leases.⁸³ Watson answered and sued Arkla as a third-party defendant.⁸⁴ Roye and Arkla filed motions for summary judgment, arguing that Watson was not entitled to share in the settlement proceeds.⁸⁵ Watson moved for summary judgment based on the argument that royalty was due on the settlement proceeds.⁸⁶ The trial court granted Roye and Arkla's motions and denied Watson's motion.⁸⁷ The court of appeals reversed and granted partial summary judgment for Watson because royalty was due on the take-or-pay settlement.⁸⁸ The Oklahoma Supreme Court granted certiorari.⁸⁹

B. Analysis

The supreme court began by affirming Arkla's dismissal from the case.⁹⁰ Under Oklahoma statutory law, Arkla owed no obligation to Watson to pay proceeds resulting from the gas purchase agreement with Roye.⁹¹ The court then discussed, at length, how other jurisdictions have ruled on the issue of whether royalty is due on take-or-pay benefits.⁹² After a brief discussion of the standard of review on appeal,⁹³ the court addressed the primary issue of whether royalty is owed on take-or-pay settlements.

80. *See id.* The contract provided, in part:

If Buyer does not receive the annual minimum which Buyer is obligated to receive hereunder during a particular Contract Year, and the annual minimum was available and tendered by Seller for delivery hereunder in accordance with the provisions of this contract, Buyer shall pay to Seller at the price per MMBtu payable hereunder on the last day of the particular Contract Year for a volume (hereinafter for convenience referred to as the "annual shortage") equal to the difference between the volume actually received during the Contract Year and the minimum volume Buyer was obligated to receive during the year. If Buyer thus pays for an annual shortage not actually received, Buyer shall have the right to recoup the volume thus paid for but not received out of future production from any or all wells delivering gas under this contract without further payment.

Id.

81. *See id.* at 1211.

82. *See id.*

83. *See Roye Realty*, 949 P.2d at 1211.

84. *See id.*

85. *See id.*

86. *See id.*

87. *See id.*

88. *See Roye Realty*, 949 P.2d at 1211.

89. *See id.*

90. *See id.* at 1211-12.

91. *See id.* The court relied on OKLA. STAT. tit. 52, § 540 (1991) (renumbered at OKLA. STAT. tit. 52, § 570.10 (Supp. 1997)). *See Roye Realty*, 949 P.2d at 1211.

92. *See Roye Realty*, 949 P.2d at 1212-14. *See also* discussion *supra* Part II. It is important to note that the *Roye Realty* court focused attention on the fact that the jurisdictions finding in favor of royalty owners were construing royalty clauses containing the term "amount realized." However, the "proceeds" royalty clause in *Roye Realty* was never expressly distinguished as a basis for adopting a plain-terms analysis.

93. *See id.* at 1216. (citing *Ross v. The City of Shawnee*, 683 P.2d 535, 536 (Okla. 1984)) (the court is confined to the record and must view all inferences and conclusions in a light most favorable to the party opposing the motion).

After stating that the lease terms determined the outcome,⁹⁴ the court held that Watson was entitled to royalty on gas produced and sold.⁹⁵ The court then defined “production” as requiring severance of gas: “[T]he word ‘produced’ as it is used in the habendum clause . . . mean[s] not only discovery of the product, but also extracting it from the ground.”⁹⁶ “[G]as is ‘sold’ when it enters the purchaser’s [pipe]line.”⁹⁷ Furthermore, “royalty” is the interest in production from the oil and gas lease.⁹⁸

The court then listed various rules dealing with contract interpretation. “[T]he intention of the parties is to be ascertained from the writing alone if possible.”⁹⁹ “The law will not make a better contract than the parties themselves entered.”¹⁰⁰ The function of the court is to enforce the contract as written.¹⁰¹ Thus, the court ruled that “viewing the lease agreement as a whole, a royalty owner, absent clear language to the contrary in the lease, is not entitled to share in take-or-pay settlements.”¹⁰² The court also denied Watson relief as a third-party beneficiary because the gas purchase contract was not made for Watson’s express benefit.¹⁰³

IV. CRITIQUE: WRONG LAW, WRONG RESULT?

A. “Production”

The *Roye Realty* court stated that “production” for the purposes of the habendum clause requires actual extraction from the ground.¹⁰⁴ The case cited for this proposition is *Walden v. Potts*.¹⁰⁵ However, the supreme court has previously rejected this interpretation. *Walden* actually stands only for the idea that after discovery of oil or gas in paying quantities, the minerals must be brought forth in pursuance of the covenants and purposes of the lease.¹⁰⁶ *Walden* has been cited previously for the erroneous proposition that production requires actual severance of the minerals.¹⁰⁷ *State v. Carter Oil Co.*,¹⁰⁸ a case before the Oklahoma Supreme Court, involved lessors seeking cancellation of an oil and gas lease for failure to actually produce from a completed gas well after the

94. *See id.*

95. *See id.*

96. *Id.* (citing *Walden v. Potts*, 152 P.2d 923 (Okla. 1944)).

97. *Id.* (citing *Wood v. TXO Prod. Corp.*, 854 P.2d 880, 881 (Okla. 1992)).

98. *See id.* (citing *Hays v. Phoenix Mutual Life Ins. Co.*, 391 P.2d 214 (Okla. 1964)).

99. *Id.* at 1217 (quoting *Panhandle Cooperative Royalty Co. v. Cunningham*, 495 P.2d 108, 113 (Okla. 1972)).

100. *Id.*

101. *See id.* (citing *Great Western Oil & Gas Co. v. Mitchell*, 326 P.2d 794, 798 (Okla. 1958)).

102. *Id.*

103. *See id.* (citing *Drummond v. Johnson*, 643 P.2d 634 (Okla. 1982)).

104. *See id.* at 1216.

105. 152 P.2d 923 (Okla. 1944).

106. *See generally id.*

107. *See State v. Carter Oil Co.*, 336 P.2d 1086, 1094 (Okla. 1958).

108. 336 P.2d 1086 (Okla. 1958).

primary term, while lessees were seeking a market.¹⁰⁹ Lessors, citing *Walden* as authority, contended that “discovery of oil or gas in paying quantities within such term is not sufficient, but that such production must be taken from the ground and marketed within such period.”¹¹⁰ The court disagreed, stating that in *Walden* discovery of production in paying quantities never occurred within the primary term.¹¹¹ The court held that production for the purposes of the habendum clause requires discovery of oil or gas capable of production in paying quantities.¹¹² The implied covenant to market then provides that the lessee should market the product within a reasonable time.¹¹³

In the most recent case addressing the question of whether gas must be extracted to be produced, the Oklahoma Supreme Court ratified the *Carter Oil* decision.¹¹⁴ In *Pack v. Santa Fe Minerals*,¹¹⁵ the court ruled that the term “produced” in an oil and gas lease does not require physical extraction of gas.¹¹⁶ The habendum clause addressed in the *Pack* case extended the term of the lease for so long as oil or gas is “produced.”¹¹⁷ The lease also contained a “cessation of production” clause that provided that the lease would terminate if production ceased for a period of sixty days.¹¹⁸ The parties stipulated that no gas was extracted under the leases for periods longer than sixty days. The royalty owner argued that no gas had been “produced” for sixty days, so the leases terminated. The producer argued that the lease is held if it is capable of producing gas, regardless of actual extraction of the gas. The court ruled for the producer, holding that so long as a well is capable of production, gas is “produced” regardless of whether the producer actually “remove[s] the product from the ground and market[s] it.”¹¹⁹

The *Roye Realty* court’s definition of production is also at odds with scholarly understanding of Oklahoma oil and gas law. In Richard Hemingway’s treatise on oil and gas law, he states that Oklahoma views discovery of production in paying quantities as sufficient to satisfy “production” under the habendum clause.¹²⁰ “Physical non-production will not terminate the lease as long as the lessee is acting as a reasonably prudent lessee under the circumstances.”¹²¹ Another treatise notes that in Oklahoma “actual production is not necessary to preserve the lease” but only “completion and capability of production” are

109. *See id.* at 1094.

110. *Id.*

111. *See id.*

112. *See id.* at 1095.

113. *See id.*

114. *See Pack v. Santa Fe Minerals*, 869 P.2d 323, 326-27 (Okla. 1994).

115. 869 P.2d 323 (Okla. 1994).

116. *See id.* at 326-27.

117. *See id.* at 325.

118. *See id.* at 327.

119. *Id.* at 326.

120. *See* RICHARD W. HEMINGWAY, *THE LAW OF OIL AND GAS* § 6.4, at 295 (3d ed. 1991) (citing *Western States Oil & Land Co. v. Helms*, 288 P. 964 (Okla. 1930); *Kolachny v. Galbreath*, 110 P. 902 (Okla. 1910); *Frank Oil Co. v. Belleview Gas and Oil Co.*, 119 P. 260 (Okla. 1911); *Parks v. Sinai Oil & Gas Co.*, 201 P. 517 (Okla. 1921); *State v. Carter Oil Co.*, 336 P.2d 1086 (Okla. 1958)).

121. *Id.*

required.¹²² Oklahoma's definition of "production" as "the capability to produce" is well recognized.¹²³ Thus, the *Roye Realty* court's treatment of production as requiring actual severance of the mineral for the purposes of the habendum clause is erroneous in light of clear precedent to the contrary that was not cited, let alone overruled, by the court in *Roye Realty*.

Finally, the Oklahoma Legislature has determined that take-or-pay payments are for gas produced and sold. Oklahoma imposes a gross production tax on the "production" of natural gas, and an excise tax on gas "produced" in the state of Oklahoma.¹²⁴ In defining when gas is "produced" for purposes of the gross production and excise taxes, the Legislature has determined that when a gas purchaser makes take-or-pay payments, the payments "are hereby deemed to be part of the gross value of gas" taken under the contract.¹²⁵ Tax is owed when the payment is received, and, if the gas is later recouped, the producer simply reports that tax has already been paid.¹²⁶ If the purchaser later waives the right to recoup the gas, the take-or-pay payments are "a premium on gas which was taken" under the gas contract.¹²⁷ Therefore, the *Roye Realty* decision departed both from the court's own prior definitions of production as well as the legislature's decision to treat take-or-pay payments as payments for the production and sale of gas.

B. "Sold"

Citing *Wood v. TXO Production Corp.*,¹²⁸ the *Roye Realty* court defines "sold" for the purposes of the royalty clause as occurring at the time the gas enters the purchaser's pipeline.¹²⁹ The issue in *Wood* was whether the lessee could deduct compression costs from royalty.¹³⁰ In other words, the issue centered on *where* gas is sold for royalty purposes—at the wellhead or downstream after compression. However, the Oklahoma decision in *Tara Petroleum Corp. v. Hughey*¹³¹ held that the market value of gas is determined *when* the gas is dedicated to a long-term gas contract, not when it is actually produced.¹³² While these two propositions are not directly inconsistent with one another, they do provide the court with "wobble-room" in deciding whether to award

122. JOHN S. LOWE, OIL AND GAS LAW IN A NUTSHELL 187-88 (3d ed. 1995). Also, the primary case-book on oil and gas law states that Oklahoma is one of the main proponents of the position that "the discovery of oil and gas before the end of the primary term is 'production' within the meaning of the term clause." EUGENE O. KUNTZ, ET AL., CASES AND MATERIALS ON OIL AND GAS LAW 202 (2d ed. 1993).

123. See, e.g., *Danne v. Texaco Exploration and Production, Inc.* 883 P.2d 210, 217 (Okla. 1994); *Pack v. Santa Fe Minerals*, 869 P.2d 323, 329 (Okla. 1994); *James Energy Co. v. HCG Energy Corp.*, 847 P.2d 333, 338-39 (Okla. 1992).

124. See OKLA. STAT. tit. 68, §§ 1001(b), 1102 (Supp. 1998).

125. OKLA. STAT. tit. 68, § 1009(g) (1992).

126. See *id.*

127. *Id.*

128. 854 P.2d 880 (Okla. 1992).

129. See *Roye Realty*, 949 P.2d at 1216.

130. See *Wood*, 854 P.2d at 880.

131. 630 P.2d 1269 (Okla. 1981).

132. See *id.* at 1272.

royalty on take-or-pay benefits. *Wood* and *Tara* are consistent with each other for the proposition that the lessor should share in all actual "proceeds" of sale. Furthermore, the decision in *Tara* indicates that, where appropriate, the supreme court will make a plain-terms analysis that takes into account the economic reality of the situation and considers the fairness to the parties.

C. Royalty Owners May Succeed Under Plain-terms Analysis

It is entirely possible that the *Roye Realty* court could have found royalty due on take-or-pay benefits using a plain-terms analysis. The court could simply have followed existing precedent which defines "production" as "capability of production" and provides that proceeds (or market value) of gas, for royalty purposes, are determined when the gas is dedicated to a long-term contract. Using these definitions (already well established under Oklahoma case law) royalty would be due on gas capable of being produced in paying quantities and sold under a long-term contract. Inasmuch as take-or-pay provisions condition the purchaser's obligation on the producer's actual ability to tender the gas,¹³³ the take-or-pay payments are made for the lessee's capability to produce. One could view take-or-pay clauses as the marketing or sale of the capability of production. Under this reasoning, the "capability of production" is sold under a long-term contract via the take-or-pay clause, and royalty is due under the plain terms of the royalty clause.

D. Characterization of Take-or-Pay Settlements

The *Roye Realty* court held that "a royalty owner . . . is not entitled to share in take-or-pay settlements."¹³⁴ In doing so, the court painted with a broad brush, failing to consider the varying components of take-or-pay settlements. A take-or-pay settlement may consist of payments settling pricing disputes, nonrecoupable take-or-pay payments, payments recoupable from post-settlement production, contract buy-down payments, and contract buy-out payments.¹³⁵ To the extent that pricing dispute settlements relate to prior production, "it is clear that the royalty owner is entitled to recover."¹³⁶ To the extent that settlement payments are recoupable from future production, even plain-terms jurisdictions recognize that royalty is owed when the purchaser exercises its right of recoupment.¹³⁷ The *Roye Realty* court's construction of the royalty clause supports the conclusion that royalty will be owed on recoupable settlement payments at the time gas is actually produced and taken pursuant to such

133. See *supra* note 80.

134. *Roye Realty*, 949 P.2d at 1217.

135. See Kramer, *supra* note 73, at §14.01. See, e.g., *Frey v. Amoco Production Co.*, 603 So. 2d 170 (La. 1992) (settlement broke down into: \$45.6 million as a recoupable take-or-pay payment, \$20.9 million as a non-recoupable take-or-pay payment and \$280.2 million as a settlement of past and future price deficiencies).

136. Bruce M. Kramer, *Royalty Interest in the United States: Not Cut from the Same Cloth*, 29 TULSA L.J. 449, 474 (1994).

137. See *Harvey E. Yates Co. v. Powell*, 98 F.3d 1222, 1236 (10th Cir. 1996).

payments. Thus, there is an implied exception to the *Roye Realty* ruling when payments are recouped through actual production. However, whether the royalty owner is entitled to the lost time value of recouped payments is unclear.

Nonrecoupable settlements of take-or-pay obligations break down into two logical subcategories: settlements of obligations not subject to recoupment at the time of settlement and settlements of obligations that would have been recoupable if not for the settlement. A settlement of nonrecoupable take-or-pay obligations does not give a royalty owner a very strong basis for argument in a plain-terms jurisdiction, because these payments would never be attributable to production. However, where a settlement payment represents take-or-pay obligations that could have been recouped by actual production, a nonrecoupable settlement extinguishes this possibility. It has been suggested that “[b]ecause the settlement precludes the take-or-pay obligation from ever ripening into an actual conveyance of natural gas (via the make-up provision), courts should treat these nonrecoupable payments as constructive production.”¹³⁸

The *Roye Realty* decision only addressed take-or-pay payments, not buy-downs or buy-outs of gas purchase contracts. The court’s holding that royalty owners are not third-party beneficiaries to a gas purchase contract, absent an express provision, limits one possible theory of recovery for royalty owners seeking royalties on settlements of other kinds of disputes between producers and purchasers. It does not, however, resolve whether other kinds of gas contract settlements are royalty bearing. However, in a recent decision by the Tenth Circuit Court of Appeals, it has been held that royalties are owed on settlements which compromise the right of the producer to pursue a higher price for production from the leased premises.¹³⁹ Since the payments are a component of the true price paid for past or future production, the payments are for actual production and royalty is owed.¹⁴⁰

The royalty owner’s primary argument is that a buy-down payment “reflects a payment for a lower future price for the natural gas that will flow under the contract.”¹⁴¹ To the extent this is true, a buy-down payment acts as prospective compensation for actual production. Especially where the renegotiated price is lower than a fair-market price and the buy-down payment is high, the settlement begins to reflect the validity of the royalty owner’s argument.¹⁴² Indeed, the producers in *Frey* acknowledged an obligation to pay royalty on the buy-down payment and did so voluntarily.¹⁴³ The corollary to *Roye Realty*’s

138. Kirk J. Bily, *Royalty on Take-or-Pay Payments and Related Consideration Accruing to Producers*, 27 HOUS. L. REV. 105, 134 (1990).

139. See *Watts v. Atlantic Richfield Co.*, 115 F.3d 785, 793 (10th Cir. 1997).

140. See *id.*

141. Patrick H. Martin, *Review of Recent Developments: 1991-1992*, 53 LA. L. REV. 891, 895 (1993).

142. See Bruce M. Kramer, *Royalty Obligations Under the Gun—The Effect of Take-or-Pay Clauses on the Duty To Make Royalty Payments*, 39 INST. ON OIL & GAS L. & TAX’N 5-1, 5-30 to 5-31 (1988) (“[I]t would be manifestly unfair for the royalty owner to accept diminished future returns and not share in the proceeds of the lump sum payment which is inuring to the benefit of the lessee.”).

143. See *Frey v. Amoco Production Co.*, 603 So. 2d 166, 170 (La. 1992). Frey received royalty on the entire \$280.2 million payment made to Amoco for settlement of past and future price deficiencies in natural gas. See *id.* The settlement of future price deficiencies represents the buy-down payment.

holding that royalties are not owed on take-or-pay settlements because they are not for "production" is that royalties are owed on buy-downs and buy-outs because such settlements are for gas already sold or to be sold in the future. *Roye Realty*'s reasoning has been interpreted as consistent with such an obligation to pay royalty on buy-down payments.¹⁴⁴ Settlements of pricing claims are royalty bearing if they relate to either past or future production actually taken by the settling purchaser.¹⁴⁵ In fact, the Tenth Circuit has found that royalties are owed on any settlement where a producer receives consideration for compromising its pricing claim.¹⁴⁶

The *Roye Realty* decision appears to limit the royalty obligation to actual production and delivery under the gas contract. Consistent with *Roye Realty*, the Tenth Circuit has held that royalty is owed on "a commensurate portion of the settlement proceeds that is attributable to price reductions applicable to future production . . . as production occurs."¹⁴⁷ The court did not address how the obligation to pay a "commensurate portion" should be calculated by the producer, but it would presumably constitute an additional premium on the gas as it is produced.

E. Harmonizing *Roye Realty*

The *Roye Realty* court apparently wanted to render a typical plain-terms decision. Since all plain-terms decisions rely heavily on a definition of "production" which requires actual physical severance of the mineral from the ground, the *Roye Realty* court did the same. However, as previously discussed, the *Roye Realty* court's definition of "production" was erroneous. This is not to say that Oklahoma courts may not define "production" as actual severance. But in order to do so without ignoring settled legal doctrine, the court would need to distinguish "production" required under the royalty clause from "production" required under the habendum clause. Yet, the court expressly treated "production" as the same for the purposes of both clauses, misdefining the term based on long-established precedent.

The striking contradiction of the court's definitions of "production" can lead to peculiar situations. For instance, a producer might not deliver any gas from a well, while receiving take-or-pay payments. There would be "production" under the habendum and cessation of production clauses, but no "production" under the royalty clause. Thus, the producer gets the benefit of holding the lease with "production," but does not have to pay royalty on the take-or-pay payments received because there is no "production."

Oklahoma is also in the unique position of being the only jurisdiction to

144. See *Watts*, 115 F.3d at 791.

145. See *id.* at 793.

146. See *id.* See also *United States v. Century Offshore Management Corp.*, 111 F.3d 443, 450 (6th Cir. 1997) (finding royalty owed on a lump sum contract buy-out payment where new contracts were executed contemporaneously with the settlement and that the lump sum was an advance payment for production under the new contracts).

147. *Harvey E. Yates Co. v. Powell*, 98 F.3d 1222, 1236 (10th Cir. 1996) (emphasis added).

define market value as the dedicated contract price while denying royalty on take-or-pay benefits.¹⁴⁸ The relationship between the two decisions may not be apparent at first glance. The decision defining market value for the purposes of the royalty clause as the dedicated contract price was based on market realities facing the parties, the probable intent of the parties, and notions of fairness to the parties.¹⁴⁹ In contrast, the *Roye Realty* decision makes a strict, plain-terms interpretation of the royalty clause without considering the underlying economic reality that take-or-pay payments are made in return for the capability to produce gas from the minerals leased by the royalty owner to the producer.¹⁵⁰ Perhaps a desire not to put additional burdens on the industry accounts for these differing methodologies.¹⁵¹ Perhaps the decisions reflect a desire to reduce the amount of litigation that would certainly proliferate if the decisions were otherwise.¹⁵² In any event, it appears Oklahoma lessors who were not protected in the market value litigation, as occurred in Texas and other states,¹⁵³ are also not protected from gas contracts that provide for consideration to the producer in the form of take-or-pay payments.¹⁵⁴

It may be possible to distinguish Oklahoma's plain-terms decision in *Roye Realty* from the decisions of courts adopting the same minority view on market value as Oklahoma. Both Louisiana and Arkansas have royalty-defining statutes that may have influenced courts applying their law to adopt the broader cooperative venture analysis.¹⁵⁵ As Oklahoma has no such statutory language, the *Roye Realty* decision may be viewed as consistent with the decisions of other jurisdictions. The fact that the royalty clauses in the *Frey* and *Klein* cases provided for royalty on "amount realized" rather than on "proceeds"¹⁵⁶ from the

148. See Lowe, *supra* note 2, at 233, 267. Oklahoma, Louisiana, and Arkansas all held that "market value" is the dedicated contract price. Louisiana and Arkansas law has also been applied to find that royalties are due on take-or-pay benefits. See *id.*

149. See *Tara Petroleum Corp. v. Hughey*, 630 P.2d 1269, 1274 (Okla. 1981).

150. See *Roye Realty*, 949 P.2d at 1216.

151. A case can be made that royalty, which operates similar to an excise tax, leads to inefficient decisions and underground waste because production burdened by royalty interests will become uneconomical before production that is not burdened by royalty interests; however, the lessees drafted lease forms that contained the royalty clause and the clause provides the lessor with the primary consideration paid for a productive lease.

152. Of course, it might be argued that the statute of limitations would have expired for many of these claims. But see Patrick H. Martin, *Review of Recent Developments: 1991-1992*, 53 LA. L. REV. 891, 896 (1993) (discussing royalty owner's attempts to circumvent the Statute of Limitations and citing *Frey* as support).

153. See, e.g., *Texas Oil & Gas Corp. v. Vela*, 429 S.W.2d 866 (Tex. 1968).

154. The Arkansas Supreme Court in *Hillard v. Stephens*, 637 S.W.2d 581 (Ark. 1982), and the Louisiana Supreme Court in *Henry v. Ballard & Cordell Corp.*, 418 So. 2d 1334 (La. 1982), both ruled against royalty owners in determining market value, following the reasoning in *Tara Petroleum Corp. v. Hughey*, 630 P.2d 1269 (Okla. 1981). However, *Klein v. Jones*, 980 F.2d 521 (8th Cir. 1992), applying Arkansas law, found in favor of royalty owners on the take-or-pay issue, as did *Frey v. Amoco Prod. Co.*, 603 So. 2d 166 (La. 1992), applying Louisiana law. With the decision in *Roye Realty*, Oklahoma royalty owners lose out on both issues.

155. See Lowe, *supra* note 2, at 257 ("[B]oth *Frey* and *Klein* were based in part upon unusual state statutes that may expand the royalty obligation Most states, including Oklahoma, apparently have no such legislation.").

156. The royalty clause in *Roye Realty* provided for royalty on gas "produced and sold" and was based on "gross proceeds" received for the gas sold. See *Roye Realty*, 949 P.2d at 1214. The royalty clause in *Klein* provided for royalty on gas "produced and sold" and was based on "market value" of such gas. See *Klein*, 980 F.2d at 525. The royalty clause in *Frey* provided for royalty on gas "sold" and was based on "amount

sale of gas is another distinguishing element. Furthermore, the *Frey* court hinted that it would use a plain-terms analysis if the royalty clause was based on “production” rather than “amount realized.”¹⁵⁷ To the extent this implication is correct, Oklahoma’s decision in *Roye Realty* is in line with *Frey*. However, as pointed out above, the way “production” and “sold” are defined in the *Roye Realty* decision is inconsistent with Oklahoma precedent. The outcome of a plain-terms analysis in Oklahoma using the established, pre-*Roye Realty* definition of “production” might have led to a different result.

V. CONCLUSION

Oklahoma’s adoption of a “plain-terms” analysis is bad news for royalty owners seeking a share of take-or-pay settlements. Nevertheless, to the extent such settlements are recoupable payments for future production, royalties should still be paid when the payments are recouped through actual production. The same is true for buy-down and buy-out payments that constitute consideration for production. While the plain-terms analysis does not necessarily destroy a theory of recovery for an Oklahoma royalty owner, the Oklahoma Supreme Court has made its convictions on the matter clear. Considering all the “wiggleroom” the court had in rendering a decision on this issue, it is likely that Oklahoma’s highest court will not waver from the current result.

realized” at the well from such sales. See *Frey*, 603 So. 2d at 169.

157. See *Frey*, 603 So. 2d at 169.